



CONDITIONING HUD GRANTS ON HOUSING MARKET OUTCOMES FURTHERS FAIR HOUSING

SALIM FURTH

Senior Research Fellow, Mercatus Center at George Mason University

EMILY HAMILTON

Research Fellow, Mercatus Center at George Mason University

Affirmatively Furthering Fair Housing: Streamlining and Enhancements
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Thank you for the opportunity to comment on the Department of Housing and Urban Development's (HUD's) proposed rule, Affirmatively Furthering Fair Housing: Streamlining and Enhancements. The Mercatus Center at George Mason University is dedicated to bridging the gap between academic ideas and real-world problems and to advancing knowledge about the likely consequences of proposed regulation for private markets. Accordingly, this comment represents the views of no particular party or interest group.

HUD has an opportunity to reform the 2015 Affirmatively Furthering Fair Housing rule to encourage local land use regulations that facilitate the agency's statutory mandate. This comment assesses opportunities for HUD to use its Community Development Block Grant (CDBG) program as a tool to encourage local reform that will permit more housing construction in locations where demand is high.

The mission of HUD to support affordable housing in the locations where economic opportunities are located is among the most important issues facing policymakers today. But HUD cannot achieve its mission without reform of the local land use regulations that stand in the way of new housing construction. The Fair Housing Act requires HUD grantees to affirmatively further fair housing. Today, many grantees have enacted zoning ordinances that prevent private property owners from providing abundant, low-cost housing to low- and moderate-income Americans.

For more information, contact
Mercatus Outreach, 703-993-4930, mercatusoutreach@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Blvd., 4th Floor, Arlington, VA 22201

Not only are HUD grantees failing to affirmatively further fair housing, but in many cases they enforce land use regimes that specifically prevent the construction of housing affordable to low- and moderate-income households. The burden of land use regulation falls disproportionately on black and Hispanic residents.

Rising home prices in cities with growing populations are not a law of nature. In *Living Downtown*, Paul Groth describes how low-cost apartments, long-term hotel rentals, and single-room occupancies provided affordable housing for low-wage workers in America's fast growing cities in the past.¹ Today, single-family zoning, minimum unit size requirements, and single-room occupancy prohibitions have largely eliminated new construction of these market-rate affordable housing typologies.

In contrast, cities that have continued to allow new housing construction have avoided skyrocketing prices. Houston has exemplified a pro-housing regulatory approach, voting down zoning,² shrinking minimum lot sizes,³ ending parking minimums downtown,⁴ and fast-tracking permitting.⁵ During a period of high demand, while the city's population increased by half a million people, median Houston home prices topped out at \$235,000, less than the national median.⁶ As a result of pro-housing policy, Houston households across a broad range of incomes can find housing that they can afford.

Economist William Fischel hypothesizes that prior to 1970, enough municipalities in growing metropolitan areas were open to new greenfield development that as some suburbs began rejecting development, developers could simply move on to another suburb.⁷ He posits that the emergence of the environmental movement in the 1970s provided a reason homeowners could organize against new development in their neighborhoods and cities while pretending not to benefit their narrow financial self-interest.⁸ Over time, this opposition resulted in regions where very little housing construction has been permitted, and increases in demand have driven prices up as a result.

The federal government has a clear interest in promoting economic growth and mobility. Policies that prevent low-income people from moving to pursue economic opportunity strain federal safety net programs and limit HUD's effectiveness.⁹ Within constitutional and statutory limits, the federal government has an interest in promoting and rewarding promarket land use policy. This public interest comment proceeds as follows:

- Section I provides an overview of current housing market conditions, the regulatory environment that constrains housing construction, and the erosion of local federalism in strictly regulated areas.

¹ Paul E. Groth, *Living Downtown: The History of Residential Hotels in the United States* (Berkeley, CA: University of California Press, 1994), 306–10.

² John F. MacDonald, "Houston Remains Unzoned," *Land Economics* 71, no. 1 (Feb 1995): 137–40.

³ Nunu Chang, "Planning the Houston Way, Part II: Special Minimum Lot Size," *OffCite*, March 21, 2018.

⁴ City of Houston, *Chapter 26 Summary of Changes*, February 22, 2013,

http://www.houstontx.gov/planning/DevelopRegs/offstreet/docs_pdfs/Chapter26_Summary-of-AmendmentsOverview.pdf.

⁵ City of Houston Planning and Development Department, *Planning and Development Expedited Review Guidelines*, May 15, 2018.

⁶ Olivia Pulsinelli, "Houston's Median Home Prices Hit All-Time Record, Leases Skyrocketed in May," *Houston Business Journal*, June 13, 2017.

⁷ William A. Fischel, "An Economic History of Zoning and a Cure for Its Exclusionary Effects," *Urban Studies* 41, no. 2 (2004): 317–40.

⁸ Fischel, "An Economic History of Zoning."

⁹ David Schleicher, "Stuck! The Law and Economics of Residential Stagnation," *Yale Law Journal* 127, no. 1 (2017): 78–154.

- Section II examines the 2015 Affirmatively Furthering Fair Housing (AFFH) rule, and the consequences of its focus on plans rather than concrete reforms.
- Section III lays out HUD’s statutory authority to encourage local land use regulation reform and the benefits and drawbacks of CDBGs as a reform incentive.
- In Section IV we develop a market test for jurisdictions that should be flagged for reform in order to receive ongoing CDBG funding and specific policy reforms that must be implemented in jurisdictions that fail the market test in order to receive ongoing CDBG grants.
- Finally, Section V distinguishes between the “entitlement communities” that receive CDBG funding and the public housing authorities and state governments that the 2015 AFFH rule also covers.

SECTION I: BACKGROUND: HOUSING MARKETS IN THE 21ST CENTURY

On the 50th anniversary of the Fair Housing Act, America’s housing markets are more segregated by income than at any time since the act was passed and possibly in the history of the nation.¹⁰ Housing is increasingly bundled with community amenities including schools, access to employment opportunities, public services, and neighborhood peer effects. This has occurred because local governments, including many CDBG entitlement communities, prohibit housing construction in the quantity that would serve low-income families.

The rising inequality in cost between metro areas now overshadows the inequality within most metro areas. For instance, metro Dallas has maintained affordability even in desirable suburbs, while the San Francisco Bay Area has allowed rent to skyrocket even in poor areas. Thus, Zillow data shows that the median two-bedroom rental listing in Frisco, Texas—an affluent suburb of Dallas with an excellent school system—is \$1,600 per month.¹¹ In Oakland, California, where three out of four school children qualify for free or reduced price meals on account of their low family incomes, the median is \$2,895 per month.¹²

The policy approach taken by HUD and most state welfare agencies to address lack of housing access has been to subsidize housing for the lowest-income families through programs such as HOME Investment Partnerships, or by imposing rent control. These approaches can backfire—by bidding up the price of a stock of apartments fixed by restrictive zoning and by inducing landlords to remove units from the rental market.¹³

¹⁰ Kendra Bischoff and Sean F. Reardon, *Residential Segregation by Income, 1970-2009* (Providence, RI: Project US2010, 2013), 4, figure 2; Ann Owens, Sean F. Reardon, and Christopher Jencks, “Income Segregation between Schools and School Districts,” *American Education Research Journal* 53, no. 4 (2016): 1159-97; Douglas Massey, “The Age of Extremes: Concentrated Affluence and Poverty in the Twenty-First Century,” *Demography* 33, no. 4 (1996): 395-412.

¹¹ Zillow Research, Median Rent List Price (\$), 2-Bedroom (dataset, July 2018 data), accessed September 7, 2018, <https://www.zillow.com/research/data/>.

¹² Education Data Partnership, “Oakland Unified,” accessed September 7, 2018, <http://www.ed-data.org/district/Alameda/Oakland-Unified>.

¹³ Scott Susin, “Rent Vouchers and the Price of Low-Income Housing,” *Journal of Public Economics* 83, no. 1 (2002): 109-52; Gabrielle Fack, “Are Housing Benefit an Effective Way to Redistribute Income? Evidence from a Natural Experiment in France,” *Labor Economics* 13, no. 6 (2006): 747-71; Michael D. Eriksen and Amanda Ross, “Housing Vouchers and the Price of Rental Housing,” *American Economic Journal: Economic Policy* 7, no. 3 (2015): 154-76; Robert Collinson and Peter Ganong, “How Do Changes in Housing Voucher Design Affect Rent and Neighborhood Quality?,” *American Economic Journal: Economic Policy* 10, no. 2 (2018): 62-89; Blair Jenkins, “Rent Control: Do Economists Agree?” *Econ Journal Watch* 6, no. 1 (2009): 73-112.

Government intervention may be necessary to provide housing to the very poorest families, but the costs of affordable housing programs in terms of both money and efficiency mount if the intervention expands to include a larger share of the market. It is only recently, and only in antigrowth coastal metropolitan areas, that market-provided housing has become unaffordable to working-class families.

Institutional Structure of Land Use Policy

Any solution to America's rent crisis must first recognize how localized the problem is and that it is fundamentally caused by constraints that erode clear property rights in a market that would otherwise provide far more housing to meet the demand. Furthermore, it must grasp that those constraints are layered, substitutable, and polycentric.

Land use decisions in US cities and suburbs are asymmetric. Landowners or managers can generally decide to shrink their supply of housing or other land uses unilaterally.¹⁴ But intensifications or use-changes of land require the explicit permission of several other semi-independent institutions.

The incentives facing landowners are generally aligned with the goals of the Fair Housing Act: where demand is high, landowners have an incentive to use land more intensively, building smaller, denser units that accommodate more residents.¹⁵ As long as the expected net present value of future rent exceeds the cost of construction and land, economic theory predicts that housing supply will expand. Edward Glaeser, Joseph Gyourko, and Raven Saks argue that construction is a very competitive industry that should be expected to bring residential real estate prices down close to costs. They refer to the difference between construction costs and prices as a city's "zoning tax," which amounts to 57 percent of the cost of housing in Manhattan.¹⁶

Incentives facing actors in the other institutions, which can potentially veto expanded housing supply, are not aligned with the goals of the Fair Housing Act. Local government officials are averse to projects that will lead to net fiscal costs for local government—and they zone accordingly.¹⁷ Neighbors bear the costs of disruptive construction and future traffic and may dislike a possible change in the "character" of a neighborhood.

Local government land use institutions are far from monolithic. A landowner interested in providing more housing may have to deal with a professional planning department, a zoning board made up of citizens, a historical commission, a neighborhood commission, public hearings, a state environmental review board, and a city department that licenses rental units.

From a bundled property rights perspective,¹⁸ the institutional failure in urban land use is not that landowners' rights are too narrow but that too many institutions and actors have the right of

¹⁴ The fact that housing is physically durable makes this rare. See Edward Glaeser and Joseph Gyourko, "Urban Decline and Durable Housing," *Journal of Political Economy* 113, no. 2 (2005): 345–75.

¹⁵ Gilles Duranton and Diego Puga, "Micro-Foundations of Urban Agglomeration Economies," in *Handbook of Regional and Urban Economics*, ed. J. Vernon Henderson and Jacques-François Thisse, vol. 4 (Amsterdam: Elsevier, 2004), 2063–2117.

¹⁶ Edward L. Glaeser, Joseph Gyourko, and Raven Saks, "Why Is Manhattan So Expensive? Regulation and the Rise in House Prices" (NBER Working Paper No. 10124, National Bureau of Economic Research, Cambridge, MA, November 2003).

¹⁷ Robert Maddox, "The Assessor's Role in Planning and Zoning," *Zoning Digest* 15, no. 4 (1963): 89–120.

¹⁸ Edella Schlager and Elinor Ostrom, "Property-Rights Regimes and Natural Resources: A Conceptual Analysis," *Land Economics* 68, no. 3 (1992): 249–62.

exclusion. Any one of these institutions can stop a project; none of them can initiate the construction of new housing.

The multiplicity of semi-independent institutions means that opponents to growth use different processes to prevent growth in different contexts.

As HUD approaches this complex problem, it should be aware that institutions can and do respond to new mandates with policies of their own. For example, Massachusetts municipalities may have used new designations of conservation land and wetlands to evade the state's "anti-snob zoning act."¹⁹ Likewise, "inclusionary zoning" mandates make multifamily projects less financially viable, and in some places have the effect of increasing average rent or exacerbating patterns of segregation.²⁰ State or federal inclusionary zoning mandates may induce unenthused municipalities to make all development more difficult.

More generally, top-down land use requirements can be a poison pill that causes markets or local policymakers to shut down development altogether. Thus, HUD must carefully consider the political equilibrium as well as the market equilibrium when it considers how to affirmatively further fair housing.

Federalism

Charles Tiebout was the James Madison of economics, crafting a theory of federalism that has endured for generations.²¹ In Tiebout's model, individuals can choose among local jurisdictions to match their own ideal tradeoff between taxes and the provision of public goods. Competition among localities effectively solves the "free rider" problem without infringing drastically on anyone's freedom: those who want more or less government can vote with their feet.

In the postwar era, Tiebout's tradeoff described the world reasonably well: most Americans could choose among ever-evolving cities, established towns, and rapidly-growing new suburbs. A generation of urban planners was taught that while NIMBYism prevailed in the suburbs, the corrupt "growth machine" of politicians and developers ran the big cities.²²

But in the 21st century, Tiebout federalism has broken down owing to the extreme cost of housing. Low- and moderate-income Americans, who are disproportionately racial minorities, are excluded from affluent cities and suburbs by governmental regulations that keep prices high by preventing new construction. For this reason and others, low-income Americans are very immobile.²³

¹⁹ Christophe Courchesne, "What Regional Agenda?: Reconciling Massachusetts's Affordable Housing Law and Environmental Protection," *Harvard Environmental Law Review* 28, no. 1 (2004): 215-47.

²⁰ Robert C. Ellickson, "The Irony of Inclusionary Zoning," *Southern California Law Review* 54 (1981): 1167-1216; Antonio Bento et al., "Housing Market Effects of Inclusionary Zoning," *Cityscape* 11, no. 2 (2009): 7-26; Jenny Schuetz, Rachel Meltzer, and Vicki Been, "Silver Bullet or Trojan Horse? The Effects of Inclusionary Zoning on Local Housing Markets in the United States," *Urban Studies* 48, no. 2 (2010): 297-329; Constantine E. Kontokosta, "Mixed-Income Housing and Neighborhood Integration: Evidence from Inclusionary Zoning Programs," *Journal of Urban Affairs* 36, no. 4 (2014): 716-41.

²¹ Charles M. Tiebout, "A Pure Theory of Local Expenditures," *Journal of Political Economy* 64, no. 5 (1956): 416-24.

²² Harvey Molotch, "The City as a Growth Machine: Toward a Political Economy of Place," *American Journal of Sociology* 82, no. 2 (1976): 309-32. NIMBY stands for "not in my back yard."

²³ Patrick Sharkey, *Stuck in Place: Urban Neighborhoods and the End of Progress Toward Racial Equality* (Chicago: University of Chicago Press, 2013).

The new exclusionism arises from a distaste for suburban sprawl,²⁴ intent to raise prices by suppressing supply,²⁵ a desire to prevent low-income students from attending schools,²⁶ environmentalism,²⁷ and the rise of regional governments.²⁸ Restoring Tiebout federalism in the rich coastal metro areas requires a general decrease in rent and home prices. The rise in home prices is recent enough in most places that many of their residents could not afford to “buy into” the neighborhood now. Without reform, these places will become less diverse and more exclusive over time, as the remaining moderate-income families gradually filter out and are replaced by uniformly high-income neighbors.

Conservatives have long, and rightly, praised localism as an alternative to large, centralized government.²⁹ But the local-government advantage diminishes as the ability to choose among locations is limited.³⁰ (Enthusiasts for regionalism should also note that choice also loses its power if competing jurisdictions all have similar policies.)

SOLUTIONS

The housing crisis can and must be solved principally by local and state policy reform. Municipalities, counties, and states can affirmatively further fair housing by clarifying and expanding property rights. In practice, that means respecting “by right” projects—rapidly approving them and making clear to neighbors that they do not possess the right of veto. It means expanding the scope of “by right” development and legalizing the subdivision of existing units for rent. It means ending the abuse of environmental protection statutes. It means moving beyond the use of zoning as a tool to limit access to jurisdiction based on income or race.

The federal role in local land use policy can and should be limited. First of all, the federal government should continue to guarantee individual rights. As Antonin Scalia noted in 1982, “federalism” cuts both ways, and the forbidding of excessive local regulation is a legitimate use of federal power.³¹

At a minimum, the federal government should not subsidize exclusionary policy. Why should national taxpayers foot the bill for rent subsidies where the rent is artificially high as a result of unreasonable limitations of private property rights? Why should HUD invest in communities that refuse to accept private housing investment? Cupertino, California, with a median family income of \$172,000 and the headquarters of the world’s most valuable company,³² received a Community

²⁴ Andres Duany, Elizabeth Plater-Zyberk, and Jeff Speck, *Suburban Nation: The Rise of Sprawl and the Decline of the American Dream* (New York: North Point Press, 2000).

²⁵ Bruce W. Hamilton, “Zoning and the Exercise of Monopoly Power,” *Journal of Urban Economics* 5, no. 1 (1978): 116–30.

²⁶ Salim Furth, “The Two-Board Knot: Zoning, Schools, and Inequality,” *American Affairs* 1, no. 4 (2017): 3–18.

²⁷ William Fischel, *Zoning Rules!: The Economics of Land Use Regulation* (Cambridge: Lincoln Institute of Land Policy, 2015), 203–5.

²⁸ Fischel, “Zoning Rules!,” 205–7.

²⁹ See, e.g., Antonin Scalia, “The Two Faces of Federalism,” *Harvard Journal of Law and Public Policy* 6 (1982): 19; Gilbert Keith Chesterton, *The Napoleon of Notting Hill* (London: The Bodley Head, 1904); Malcolm Tait and Andy Inch, “Putting Localism in Place: Conservative Images of the Good Community and the Contradictions of Planning Reform in England,” *Planning Practice and Research* 31, no. 2 (2016): 174–94.

³⁰ Emily Hamilton, “The Case for Preemption in Land-Use Regulation,” Mercatus Center at George Mason University, July 20, 2017.

³¹ Antonin Scalia, “The Two Faces of Federalism.”

³² US Census Bureau, “Selected Economic Characteristics, 2012-2016 American Community Survey 5-year Estimates, Cupertino city, California,” accessed September 10, 2018; Seung Lee, “Apple Becomes First U.S. Company to Hit \$1 Trillion Market Value,” *The Bulletin*, August 2, 2018.

Development Block Grant to build sidewalks.³³ At the same time, the city maintains rigid single-family zoning in most of its land area and has approved building permits at a pedestrian rate despite rocketing demand.

In the final sections of this comment, we will propose a framework for enforcing the Fair Housing Act's mandate that participating communities affirmatively further fair housing by leveraging CDBG funding as an incentive for locally chosen policy reforms.

SECTION II: PROGRESS UNDER THE AFFIRMATIVELY FURTHERING FAIR HOUSING RULE

The 2015 AFFH rule required policymakers in jurisdictions receiving HUD funding to examine segregation in their jurisdictions and opportunities for state and local reform. The program identified several major cities that were required to create plans for reform based on their levels of housing and service segregation. Identification of these segregated jurisdictions and creating these plans required extensive resources from both HUD and the municipalities. However, there is little to no evidence that these planning efforts have increased access to housing in exclusionary neighborhoods for low-income people or minorities.

Kansas City, Missouri, is one jurisdiction that was identified as needing a plan to improve integration under the AFFH rule, and it complied by working with the local Mid-America Regional Council (MARC) to submit a report.³⁴ One of the plan's stated goals is to "develop model zoning code for smaller homes on smaller lots and small (4-12 unit) multifamily."³⁵ The plan was published in 2016, so it may be too soon to evaluate whether or not the region will carry out its goal to upzone, but so far, it has not. In commenting on the report, MARC staff member Marlene Nagel emphasized a shortage of federal funds for affordable housing rather than focusing on the potential for localities to upzone themselves. She said, "Everyone says we don't have the resources to address the challenges [described] in the plan. I think that attitude hasn't changed, because they are feeling like we are all doing as much as we can do with the resources we have."³⁶ Under the AFFH rule, the Kansas City region met the requirements to receive ongoing HUD funding by publishing this report whether or not it achieves any of the goals in the report.

Rather than relying on local policymakers' vague and unenforced commitments to integrate, HUD should tie the disbursement of CDBG grants to clear requirements for already-enacted zoning deregulation or reforms to the entitlement process that reduce the cost of building new housing. HUD should set clearly defined metrics at which cities must begin permitting more housing, if they want to continue receiving grants. Past HUD efforts to use AFFH to increase access to opportunity, while well intentioned, have failed to induce the deregulation needed to open up exclusionary jurisdictions.

The 2015 AFFH rule required cities and counties to use a software package to estimate their level of racial and income integration in housing and services. However, rather than requiring specific reforms, such as upzoning, that would allow more lower-income people to access exclusionary neighborhoods and school districts, the rule required jurisdictions to create plans for

³³ US Department of Housing and Urban Development, "Integrated Disbursement and Information System, Expenditure Report, Use of CDBG Funds by CUPERTINO, CA from 07-01-2016 to 06-30-2017," June 19, 2018.

³⁴ *Plan for Affirmatively Furthering Fair Housing* (Kansas City, MO: Mid-America Regional Council, 2011).

³⁵ *Plan for Affirmatively Furthering Fair Housing*.

³⁶ Jake Blumgart, *Fair Housing at 50* (Chicago: American Planning Association, 2018).

integration. Because current local policies allow new housing construction to be vetoed at so many points, a plan for more integration could easily be blocked by other policies. For example, a city could reform zoning to allow multifamily housing in all neighborhoods, seemingly a big step toward allowing income integration. But the city could then put so many exactions on multifamily housing that none of it ever gets built.

Thus, we concur with the sense of the Advance Notice of Potential Rulemaking that the AFFH rule should be revised to require less administrative burden, to focus on clear outcomes rather than resource-intensive planning and reporting.

SECTION III: REFORMING AFFH TO REQUIRE OUTCOMES RATHER THAN PLANS

In order to incentivize actions rather than plans, HUD should revise the 2015 rule to make CDBG funds contingent on clear policy requirements and market outcomes for states and entitlement communities. The 2015 rule would have withheld all HUD funds from grantees that failed to make plans to affirmatively further fair housing. Under this policy, residents in an exclusionary jurisdiction could be further harmed by the withdrawal of HUD funds through the HOME Investment Partnerships Program (HOME), Emergency Solutions Grants, and Housing Opportunities for Persons with AIDS. Unlike CDBG, these other programs are used almost exclusively to provide direct support to house low-income people. Thus, we recommend withholding only CDBG funding from jurisdictions that fail HUD's test.

We take as given the current statutory requirements that determine HUD's authority and funding formulas, but this should not be taken as an endorsement of the current programs or their formulas. Within this framework, leveraging grants is one of the few ways HUD can encourage local reform, and CDBG is the funding tool most likely to encourage local policy reform. To be sure, CDBG is not an ideal incentive for reform, because small, highly exclusionary jurisdictions may not receive CDBG funding. Furthermore, because exclusionary zoning correlates with high incomes and large tax bases, exclusionary jurisdictions may prefer to opt out of HUD funding rather than affirmatively further fair housing.

Although CDBG funding is not proportionate to the need for upzoning, it is nonetheless a good tool for encouraging local government reform. The stated purpose of CDBG is to support housing, economic development, and infrastructure.³⁷ The funds come with few restrictions on how they can be used. Potential uses for CDBG funds include public services, acquisition of real property, and public facilities and improvement.³⁸

In part because the funds can be used so flexibly, CDBG enjoys broad popularity with local government officials who can use the funds to support their priorities.³⁹ CDBG funds have been used to support brew pubs, historic sites, and marinas.⁴⁰ In most cases, cutting CDBG funding to entitlement communities that use land use regulation to obstruct HUD's objectives will not directly harm residents who are struggling to afford housing. However, according to a Politico poll,

³⁷ US Department of Housing and Urban Development, "Community Development Block Grant Program - CDBG," accessed September 11, 2018, https://www.hud.gov/program_offices/comm_planning/communitydevelopment/programs.

³⁸ US Department of Housing and Urban Development, *Guide to National Objectives & Eligible Activities for Entitlement Communities*, chapter 2, 2-2.

³⁹ *CDBG Works: How Mayors Put CDBG to Work* (Washington, DC: United States Conference of Mayors, 2017).

⁴⁰ Scott Shackford, "The Community Development Block Grant Program Is Awful and *Should* Be Cut," *Reason*, March 16, 2017.

63 percent of mayors said that losing CDBG funding would be “devastating” for their communities, a higher percentage than said the same for federal funding for housing, education, transportation and infrastructure, public safety, or legal aid for low-income residents.⁴¹

A municipality’s eligibility for CDBG funding under current formulas is not a guarantee that they will receive these funds. The Fair Housing Act gives HUD the mandate to enforce the goal of affirmatively furthering fair housing, so the agency has the statutory ground to withhold funds from jurisdictions that stand in the way of the goal. Jurisdictions that use land use regulations to shut out low-income residents should not receive subsidies from a program with the objective of “providing decent housing and a suitable living environment, and by expanding economic opportunities, principally for low- and moderate-income persons.”⁴² If jurisdictions with exclusionary zoning put CDBG funds to use in a way that increases the amenity value of their region, CDBG-funded projects may lead to an increase in house prices, further restricting access for low-income households and actively working against the program’s goal.

Conditioning CDBG grants on reform would not preempt local regulations. CDBG grants can serve as an incentive for municipalities to reform exclusionary zoning without requiring them to do so. Using CDBG funding as an incentive for land use reform furthers HUD’s mission without violating the freedom for policy experimentation at the state or local level.

Preemption of local land use regulations is, however, a legal recourse of state governments because municipalities are “creatures of their states.” Economist Michael Farren has argued that, while federalism serves citizens best when rulemaking is devolved as far as possible, higher level governments maintain a role to protect property owners’ rights from over-regulation at the local level.⁴³ This principled case for preemption rests on the state’s duty to protect property owners’ rights to determine the best use of their land.

Rather than providing a check against exclusionary zoning, the states where low- and moderate-income people have the least access to housing have largely upheld complete local control, or even added further potential vetoes to projects on environmental grounds.⁴⁴ Local policymakers have proved to be highly responsive to local nuisance concerns—to the detriment of the property rights of landowners and the concerns of rent-burdened residents.⁴⁵ In keeping with its mission to advance housing affordability, HUD should also consider withholding CDBG grants to states that have used their preemptive power to erode rather than protect individual rights as they pertain to housing supply.

While local government restrictions on housing construction are the primary policy cause of housing supply restriction and high and rising prices, past federal government policies have exacerbated housing shortages. Under the Housing Act of 1937, federal transfers to localities

⁴¹ Aidan Quigley, “Why Trump’s Budget Terrifies America’s Mayors,” *Politico Magazine*, April 24, 2017.

⁴² US Department of Housing and Urban Development, “Community Development Block Grant Entitlement Program,” <https://www.hudexchange.info/programs/cdbg-entitlement/>.

⁴³ Michael Farren, “Nirvana’s Night Watchman: A Response to Adam Thierer,” Mercatus Center at George Mason University, July 26, 2017.

⁴⁴ Fischel, *Zoning Rules!*, 54–7; Jennifer Hernandez, David Friedman, and Stephanie DeHerrera, *In the Name of the Environment: How Litigation Abuse under the California Environmental Quality Act Undermines California’s Environmental, Social Equity and Economic Priorities – and Proposed Reforms to Protect the Environment from CEQA Litigation Abuse* (California: Holland & Knight, 2015).

⁴⁵ David Schleicher, “Why Is There No Partisan Competition in City Council Elections?: The Role of Election Law,” *Journal of Law and Politics* 23, no. 4 (2007): 419–73.

provided the funds for slum clearance and urban renewal projects that eliminated hundreds of thousands of urban housing units, primarily units occupied by low-income tenants.⁴⁶ While these programs may have improved the average quality of the remaining housing stock, they left low- and moderate-income people to compete for a reduced stock of housing that they could afford. The effects of these programs are still felt today in high-cost cities.⁴⁷

Given the history of federal programs making housing conditions worse for the country's most vulnerable populations, the first principle for reforming AFFH should be "do no harm." Regulators should proceed with caution and a hyper-awareness of potential unintended consequences based on the past outcomes of federal intervention in land use policy.

SECTION IV: RECOMMENDATIONS FOR REFORM: ENTITLEMENT COMMUNITIES

HUD should replace the Assessment of Fair Housing (AFH) tool with an evaluation that is simple, transparent, and qualifies communities based on their outcomes and policies rather than their good intentions.

We recommend a two-part test, holding communities to account for market outcomes and requiring that expensive, slow-growing communities move policy in a direction that affirmatively furthers fair housing. In order to receive CDBG, HOME, or other funding as an entitlement community, each jurisdiction would need to pass one of the two tests.

Market Test

The market test would verify that if a community faces high housing demand, it is meeting at least some of that demand through increased housing in some form. Formally, a community must be able to answer "yes" to at least one of the following four questions:

1. Is rent below the US median?
2. Is rent below the average in its metropolitan area?
3. Did real rent decline, on net, over the past five years?
4. Did the jurisdiction or its constituent parts issue net building permits for new housing units equal to at least 5 percent of its housing stock over the past five years?

For the purposes of questions 1 and 3, "rent" is Small Area Fair Market Rent for a three-bedroom unit as calculated by HUD, averaged across the ZIP codes that constitute the jurisdiction in question. For question 2, HUD publishes a ZIP/CBSA ratio that indicates whether local Fair Market Rent is above or below the metropolitan average; this should be averaged across ZIP codes in a jurisdiction. "Net building permits" denotes the number of residential units permitted for construction minus the number of residential units permitted for demolition.

The first three questions allow municipalities with low or falling rent to qualify: they may face low demand or a recession. Such communities are likely to have high rates of poverty and fewer local resources to address challenges.

⁴⁶ William J. Collins and Katherine L. Shester, "Slum Clearance and Urban Renewal in the United States" (NBER Working Paper No.17458, National Bureau of Economic Research, Cambridge, MA, November 2012).

⁴⁷ Groth, *Living Downtown*.

The fourth question gets to the heart of the housing crisis: where rent is high and rising, are governments allowing the private sector to do its part in alleviating rent burdens?

We expect that in high-cost coastal markets a substantial fraction of entitlement communities will fail the market test. In less-costly and fast-growing areas, a few particularly exclusive jurisdictions would fail the test, many of which are not CDBG entitlement communities in any case.

Policy Test

Jurisdictions that fail the market test can maintain their entitlement community status by passing the policy test, which would require each community to document at least one step it has taken in the past five years to affirmatively further fair housing by reforming public institutions in ways that clarify and strengthen property rights and promote market affordability. HUD would provide a list of qualifying policy reforms, such as the following:

Expand by-right housing development

- Expand multifamily zoned areas by at least 1 percent of the land area of the jurisdiction
- Allow duplexes, triplexes, or fourplexes in at least one-fourth of areas zoned primarily for single-family residential
- Allow manufactured homes in at least one-fourth of areas zoned primarily for single-family residential
- Allow multifamily development in retail and office zones
- Allow single-room occupancy development wherever multifamily housing is allowed
- Reduce minimum lot sizes by at least 50 percent in at least 25 percent of residential zoned areas
- Reduce the number of buildings protected by historic preservation by at least 25 percent
- Increase allowable floor area ratio (FAR) by at least 25 percent in multifamily areas that must cover at least 5 percent of the land in the jurisdiction
- Create transit-oriented development zones that account for at least 5 percent of the city's residential zones and allow for a FAR of 10 or greater

Reduce costs of development

- Eliminate parking minimums
- Adopt parallel-process permitting
- Establish one-stop permitting
- Allow prefabricated construction
- Eliminate minimum unit size requirements
- Eliminate architectural standards other than those required for safety

Expand use rights in existing building stock

- Allow conversion of office units to apartments

- Allow subdivision of single-family homes into duplexes
- Allow accessory dwelling units (including detached accessory dwelling units) on all lots with single-family homes
- Allow detached (attached) accessory dwelling units at single-family homes that already have an attached (detached) accessory dwelling unit
- Legalize short-term home rentals
- Legalize home-based businesses
- Legalize single-room-occupancy boarding houses

Revolutionize local land use institutions

- Adopt land value taxation
- Adopt additive zoning
- Adopt form-based zoning
- Adopt non-zone-based regulatory framework
- Adopt pre-approved plans for accessory dwelling units, single-family homes, duplexes, triplexes, and fourplexes
- Reform subdivision regulations to allow for traditional mixed-density and mixed-use neighborhoods in new development

In addition, where a locally originated idea achieves similar goals, the applicant can submit the policy with a brief justification. HUD should put a tight limit on length—perhaps 2,000 words—and take a good-faith view of submissions. The primary requirement is that the policy must be in effect—not merely introduced, proposed, or planned—at the time of submission.

In application, HUD will have to attach some limits to these reforms: a reform is not a reform if it only applies to a small site, requires onerous fees or permitting time, or if it is offset by countervailing policy in another area. Reforms that reverse a restriction instated in 2018 or later should not qualify. However, some amount of system-gaming will have to be tolerated to keep the reporting requirements from becoming a burden in themselves.

Since this test is conceived as a five-year retrospective evaluation, it should be phased in. Communities that fail to pass either part of their test in the first five years after the final rule is promulgated should forfeit CDBG funding on a prorated basis until their next authorization. That is, a community that fails the test four years after the final rule is promulgated should lose 80 percent of its CDBG funding until it reauthorizes itself as an entitlement community.

SECTION V: HUD FUNDING OUTSIDE OF ENTITLEMENT COMMUNITIES

While the 2015 rule required HUD grantees, including public housing authorities (PHAs) and states, to conduct an Assessment of Fair Housing to submit to HUD, the above test for CDBG entitlement cities and counties receiving CDBG funding cannot and should not be applied directly to other grantees.

PHAs should be exempted from the assessment process entirely. We know of no allegation that public housing authorities are systematically engaged in exclusionary practices. These

agencies exist to serve low-income tenants. Nationally, 84 percent of public housing residents earn less than 50 percent of the median income, and their average annual income is \$14,922.⁴⁸ Forty-two percent of public housing residents are black and 19 percent are Hispanic, compared to about 12 percent each for the country as a whole.⁴⁹

Because PHAs typically have little or no influence over the rules that stand in the way of access to housing that serves low- and moderate-income people, HUD does not need to implement a time-consuming assessment process aimed at PHAs. Of course, PHAs remain obligated to comply with the Fair Housing Act and all other civil rights statutes.

With respect to the CDBG State Program, however, HUD should withhold funds from grantee states that stand in the way of affirmatively furthering fair housing. Real estate market outcomes will naturally vary widely across states, so the market and policy tests developed above cannot reasonably be applied at the state level. Rather than using a quantifiable metric to establish state eligibility for CDBG funding, HUD should consistently monitor state policy for violations of affirmatively furthering fair housing. If state policies are found to stand in the way of HUD's mandates, their CDBG funds should be withheld.

State policies that prevent housing construction that serves low- and moderate-income people may include rules that create additional veto points for new development, rules that prevent development directly (such as statewide growth management), or discriminatory tax policy that discourages new housing construction.

For example, the California Environmental Quality Act (CEQA) introduces a state-level veto point for new development. The law allows residents to sue to block development based on any environmental concern, such as carbon emissions or loss of animal habitat. While CEQA provides a tool for any state resident to delay or prevent new development,⁵⁰ it may actually harm environmental quality if it is used to displace development from dense parts of the state to California areas or other states where housing construction faces fewer obstacles but per capita carbon emissions are higher.⁵¹

State tax laws may also discourage development. For example, property tax caps shield homeowners from being taxed proportionate to their home value. As a result, these caps lower the cost of holding on to a property rather than selling it to someone who may redevelop the site to provide housing for more people.⁵²

Proposition 13, another California example, has particularly pernicious consequences for housing construction. The law limits annual property taxes to 1 percent of a property's value, and it limits assessments to increasing at a rate of 2 percent per year from 1975 as long as the property's ownership doesn't change. Under the rapid property appreciation that many California homeowners have enjoyed, Proposition 13 privileges taxpayers who happened to purchase their homes before others who now have to pay higher rates. Proposition 13 benefits are even inheritable

⁴⁸ US Department of Housing and Urban Development, "Resident Characteristics Report," accessed September 13, 2018, https://www.hud.gov/program_offices/public_indian_housing/systems/pic/50058/rcr.

⁴⁹ US Department of Housing and Urban Development, "Resident Characteristics Report."

⁵⁰ Mac Taylor, *California's High Housing Costs: Causes and Consequences* (Sacramento, CA: Legislative Analyst's Office, May 17, 2015), 18, <https://lao.ca.gov/reports/2015/finance/housing-costs/housing-costs.pdf>.

⁵¹ US Energy Information Administration, *Energy-Related Carbon Dioxide Emissions by State, 2000–2015*, September 13, 2018.

⁵² Mac Taylor, *Common Claims about Proposition 13* (Sacramento, CA: Legislative Analyst's Office, September 2016), 34, <https://lao.ca.gov/reports/2016/3497/common-claims-prop13-091916.pdf>.

for children and grandchildren of homeowners, so the antidevelopment consequences can carry on even beyond the death of a beneficiary.⁵³

The mandate to affirmatively further fair housing gives HUD reason to withhold CDBG funds from states that discourage housing construction through property tax caps. In cases where states fund public works projects with CDBG because they refuse to rely on their own tax base, the nexus for withholding support is even clearer.

CONCLUSION

HUD has an opportunity to use CDBG grants to entitlement communities and states as a tool to encourage land use policy that advances its mandate to affirmatively further fair housing. CDBG funds are highly popular with those policymakers who are in a position to reform land use policy to allow for more construction. Setting market and policy tests that limit this funding source to the jurisdictions that make it possible to affirmatively further fair housing for low- and moderate-income residents who are disproportionately racial minorities is statutorily appropriate and has the potential to improve outcomes.

⁵³ Liam Dillon and Ben Poston, "California Homeowners Get to Pass Low Property Taxes to Their Kids. It's Proved Highly Profitable to an Elite Group," *Los Angeles Times*, August 17, 2018.